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The Institute is a nonprofit research organization devoted to finding and promoting solutions to employment-related problems at the national, state, and local level. The Institute is an activity of the W.E. Upjohn Unemployment Trustee Corporation, which was established in 1932 to administer a fund set aside by the late Dr. W.E. Upjohn, founder of the Upjohn Company, to conduct research on the causes and effects of unemployment and seek measures for the alleviation of the hardships suffered by the unemployed.

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"Smart" Economic Development

[Editor's note: This article is part of a series on "Research Questions for the New Millenium." The series aims to identify research needed to inform employment policy in the near future.]

Economic development organizations are acting smarter today, promoting "smart parks" (wired business parks), business accelerators, and conducting industrial cluster analyses. Still, academic researchers generally believe that there is room for improvement, and they advocate even smarter economic development policies that can help alleviate poverty and promote regional productivity.

In particular, most researchers insist that smart economic development would avoid the blanket use of tax incentives and state grants to lure businesses across state lines. However, these programs remain the mainstay to most economic development efforts. Critics of the economic development subsidies offered by states argue that they may generate results that are worse than zero-sum, because limited public dollars are being used to promote non-market-based location decisions instead of providing public goods. Practitioners argue that tax and finance incentives are crucial as states battle for that next plant opening.

Researchers agree that economic growth is better than no growth and that it is associated with improving conditions for economically disadvantaged persons. Madden (2000), in her study of the nation's 198 largest MSAs, found that economic growth—regardless of whether it is in the core city or in the surrounding suburbs—reduces metropolitan poverty; "[t]herefore, all policies designed to promote growth in jobs are antipoverty policies" (p. 162). Bartik (1991) found that economic growth has long-term positive effects on wage growth, career advancement, and unemployment. However, researchers are quick to point out that the effects of economic development programs depend upon how they are financed. If disadvantaged households are burdened by greater taxes or are negatively affected by cuts in public services, economic development could do more harm than good.

Advocates of smart economic development believe that economic development organizations should look beyond economic incentives and toward the following issues.

Focusing Economic Development Incentives to Areas of High Unemployment

Bartik suggested that since the net difference between wage offers and the reservation wages of area workers tends to be larger in economically depressed areas, successful economic development efforts will generate greater economic benefits in these areas. Second, development in these areas would eliminate the spatial barriers in transporta-

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tion and employment information flows faced by job-seeking residents.

Because companies only consider private gains and not possible social gains of locating in brownfield or depressed areas, the social benefits generated by the development of locally depressed areas would probably not exist without public policy intervention. Unfortunately, Fisher and Peters (1998, p. 212) found that most states do not have any clear incentives for firms to invest in places of high unemployment. This is changing, however; for example, the state of Michigan has introduced tax-free (excluding sales taxes) Renaissance Zones for economically depressed urban and rural areas. Moreover, as of 1995, 34 states operated state enterprise zone programs that offer tax and economic incentives for firms that invest in more than 2,800 economically distressed areas.

Enhancing Areas' Economic Competitiveness

Porter (1990) and other regional researchers have suggested that communities should focus their economic development efforts on assisting their key industrial clusters in becoming global competitors. Porter argued that an area's economic success depends on the quality of its resources and suppliers, a customer base which demands quality products or services, and intraregional firm rivalry.

Cluster analysis can be viewed as being part of a larger scope of research that examines the spatial factors of product development and production. For many years, regional economists have explored the factors determining an area's place in its industries' product cycles. Some areas appear to be better incubators of products/services, while others are better production sites. Researchers and practitioners alike are interested in promoting regional policies that encourage product/service development that would enable the area to keep and maintain the more creative edge of its core industries.

Entrepreneurship development is a key element of this spatial approach to economic development. Entrepreneurs can both generate the spark that could result in the area's next core cluster or (more likely) promote the cluster's longevity by generating new products, new demand, or new suppliers. Likewise, business technology assistance programs, such as the manufacturing extension services, are efforts designed to improve an area's productivity. The role that universities and community colleges take in shaping the region's place in its industries' product cycles will surely get more attention in the coming years.

Conducting Solid Evaluations of Current Economic Development Efforts

State and local economic development efforts seldom spend the time or money necessary to conduct reasonable evaluation studies of their programs, because poor results could jeopardize the effort. Yet, without such studies it is difficult for these organizations not to mismanage resources. The barriers to conducting solid evaluation studies, however, are not limited to political intransigency alone. Classic evaluation studies require data that are seldom available. The inability to conduct a controlled experiment, for example, forces researchers to conduct historical studies using advanced econometric techniques to control for selection bias (a major problem in small business and manufacturing assistance programs), to rely on subjective survey opinion data, or to conduct cross-section regional studies where the "treated" community's performance is compared with that of similar communities. A recent development along this line is community benchmarking, in which a community measures its performance on key factors relative to similar communities (see Erickcek and Watts 2000).

Innovative Workforce Development Programs

The Cleveland Center for Employment Training (CET) is a nonprofit organization currently offering five specialized open-entry and open-exit training programs for occupations in high demand by local business. Local governments provide 94 percent of the program's budget, and area firms play a key role in course design and instruction. Since 1967, the program has trained and placed 70,000 persons.

The Portland, Oregon, JobNet linked economically disadvantaged job seekers to job openings in firms receiving economic development assistance from the Portland Development Commission (PDC). To obtain financial assistance by the PDC, firms were required to sign a "First Source" agreement, requiring them to consider disadvantaged job applicants selected by the JobNet Program. These candidates were screened and trained for entry-level positions by various training organizations that were associated with the JobNet effort. From 1989 to 1996, JobNet placed, on average, 700 disadvantaged persons into jobs. Unfortunately, the program was eliminated due to the lack of strong local neighborhood support as the state consolidated training programs into one-stop centers.

The Minneapolis Neighborhood Employment Network (NET) is an activity of the mayor's office that works with 11 neighborhood affiliates to link economically disadvantages persons to private job openings. In short, the program depends on its job developers finding job openings, which are passed quickly to the neighborhood affiliates who recruit and screen potential job candidates.

The Milwaukee Career Cooperative is a nonprofit, temp-to-perm employment agency working in five inner-city neighborhoods in Milwaukee. A job developer works to find temporary job openings that can lead to permanent employment after no longer than a 90-day period. Candidates from the five neighborhoods, who are screened and provided job retention training, apply for the openings. The cooperative receives a service fee from the employer as would a private employment agency. The fee accounts for approximately 75 percent of the program's costs; the remainder is covered by foundation and government sources.

Integrating Workforce/Human Development Efforts with Local Economic Development Efforts

Local workforce development and economic development efforts tend not to work together effectively, even though they are striving for the same goal of improving the employment and income opportunities of area residents. This is unfortunate because in a competitive, full-employment environment, firms may not be able to raise wages to attract workers and may be able to grow only through increasing the number of area residents who are ready to work. Business-directed, community-based training programs are now found on all levels. For example, the various Centers of Employment Training (CETs) sites across the country are neighborhood-focused training programs that concentrate on teaching key skills needed by neighboring firms. On the city level, the discontinued JobNet in Portland, Oregon, required businesses using city economic incentive programs to give disadvantaged individuals a fair chance in obtaining employment. On the state level, several states subsidize employee training through their community colleges.

As both academic researchers and practitioners look for ways to act smarter, the following questions should be explored.

1) How can communities develop and maintain long-term job training programs that meet employers' needs and break employment barriers for economically disadvantaged individuals?

2) What is the economic role of smaller metropolitan areas in the changing global environment, as product cycles shorten and industrial networks become international?

3) How can programs be better evaluated or, more importantly, how can future programs be better designed so that evaluations become a means to "adjust the course" and not to a threat to "pull the plug"?

Clearly, the worlds of practitioners and researchers are different. Researchers worry about employment displacement, cost-benefit ratios, and selection bias in evaluation studies, whereas practitioners agonize about generating jobs. Still, both sides agree that an effective economic development program depends on communities' ability to link businesses, governments, and other stakeholders effectively, and that this effort will depend upon community leadership. This leads to the final major question to be addressed in the coming years: how do we foster the necessary leadership to create and support active business-education-government partnerships for effective local workforce/economic development programs?

Suggested readings:

Anderson, John E., and Robert W. Wassmer. 2000. *Bidding for Business: The Efficacy of Local Economic Development Incentives in a Metropolitan Area.* Kalamazoo, Michigan: W.E. Upjohn Institute for Employment Research.

Bartik, Timothy J. 1991. *Who Benefits from State and Local Economic Development Policies?* Kalamazoo, Michigan: W.E. Upjohn Institute for Employment Research.

Erickcek, George A., and Brad R. Watts. 2000. *The Benton Harbor Area Benchmarking Study.* 5th ed. Available at http:\\www\upjohninst.org\regional\benton-harbor-final.pdf (December 2000).

Fisher, Peter S., and Alan H. Peters. 1998. *Industrial Incentives: Competition among American States and Cities.* Kalamazoo, Michigan: W.E. Upjohn Institute for Employment Research.

Madden, Janice F. 2000. *Changes in Income Inequality within U.S. Metropolitan Areas.* Kalamazoo, Michigan: W.E. Upjohn Institute for Employment Research.

Porter, Michael. 1990. *The Competitive Advantage of Nations.* New York: Free Press.

George Erickcek is the senior regional analyst at the W.E. Upjohn Institute.

Kimmel to Leave Institute

Jean Kimmel, a senior economist at the Upjohn Institute, has accepted a position as associate professor in the Department of Economics at Western Michigan University, Kalamazoo, Michigan.

Kimmel has worked at the Institute since 1989. Before coming to the Institute, Kimmel worked for the University of North Carolina as a graduate student lecturer, teaching assistant, and research assistant. She has also worked as a visiting assistant professor and an adjunct associate professor for Kalamazoo College and Western Michigan University, respectively. She received a B.A. degree at George Washington University, and she went on to receive an M.A. degree at the University of Delaware and a Ph.D. at the University of North Carolina at Chapel Hill in 1990.

Since her arrival at the Institute twelve years ago, Kimmel has performed policy-relevant research in the areas of "moonlighting," welfare-to-work, employment-related child care issues, and health and employment behavior. She has written several working papers for the Institute, and her work has been published in *Canadian Public Policy, Review of Economics and Statistics, Labour Economics, The Journal of Monetary Research,* and *American Economic Review.* She has also contributed to two books, both of which are expected to be published this year.

Kimmel has also lectured at numerous conferences. Most recently she spoke on "The Returns to Education and Basic Skills Training for Individuals with Poor Health or Disability" (co-authored with the Institute's Kevin Hollenbeck) at the Allied Social Sciences Associations annual meeting. She is scheduled to give a presentation (co-authored with Lisa Powell) at a May conference titled "From Welfare to Child Care: What Happens to Infants and Toddlers When Single Mothers Exchange Welfare for Work?"

Kimmel will join the Department of Economics faculty at Western Michigan University in Fall 2001.

Terry Thomason, Timothy P. Schmidle,
and *John F. Burton, Jr.*

Workers' Compensation under Alternative Insurance Arrangements

One of the most important differences among state workers' compensation programs concerns the insurance arrangements for providing workers' compensation coverage. State laws prescribe workers' compensation benefits, but these laws assign to employers the responsibility for providing benefits. The employers obtain workers' compensation coverage to provide these benefits by one of three mechanisms, depending upon the options available in their state. They may purchase insurance from 1) a private insurance carrier, 2) a competitive state workers' compensation fund, or 3) an exclusive (monopolistic) state workers' compensation fund. In addition, self-insurance is available in almost every state upon satisfying prescribed criteria. This commingling of private (insurance carrier) and public (state fund) approaches to providing workers' compensation benefits is a distinctive feature of workers' compensation in the United States.

Another important difference is the degree to which workers' compensation insurance pricing has been deregulated. The private provision of workers' compensation in the United States was highly regulated until recently. Carriers were subject to "pure administered pricing," under which maximum permissible rates were largely determined by state rating bureaus, and the rates charged by carriers were subject to prior approval by state insurance commissions. However, most states in recent years have dismantled (to varying degrees) their systems of regulation for workers' compensation insurance pricing. In fact, the deregulatory movement begun by just a few states in the early 1980s has become so widespread that now only a few jurisdictions continue to use the pure administered pricing approach.

In our recent book, *Workers' Compensation: Benefits, Costs, and Safety under Alternative Insurance Arrangements* (2001, W.E. Upjohn Institute), we use a unique panel data set of state-level data for 48 jurisdictions between 1975 and 1995 to explore the effects of insurance arrangements on workplace safety, the structure of the workers' compensation insurance market, and the employers' cost of workers' compensation insurance. In addition, we examine the trade-off between the benefit adequacy and affordability objectives of state workers' compensation programs and estimate the impact that the imposition of federal standards for benefit adequacy would have on workers' compensation costs.

There is substantial debate about the relative merits of public versus private provision of workers' compensation insurance and about the regulation of private-carrier-provided workers' compensation insurance. This debate has, for the most part, centered on questions concerning the availability and affordability of compensation insurance, since these two variables are relatively easy to measure. However, questions have also been raised regarding the "quality" of services provided to the parties to workers' compensation. Labor advocates, for example, have been particularly concerned that the profit motive causes insurers to unjustly deny claims or otherwise impede the delivery of benefits to workers, thus exacerbating the adverse consequences of workplace injuries or diseases.

Here, we focus on our results and conclusions with respect to only one of the research questions we addressed: the impact of the deregulation of the workers' compensation insurance market on employers' costs.

Deregulation and Employer Costs

Economic theory fails to offer unambiguous predictions about the impact of the regulation of rates in private insurance markets. In part this is because these effects depend on the behavior of the regulatory agency, which is driven by political rather than economic considerations. A regulatory body that aligns itself with employer-consumers of workers' compensation insurance will suppress rates below competitive levels (at least in the short run). On the other hand, regulators who are more responsive to the insurance industry may help cartelize the market, resulting in supra-competitive rates. Even those regulatory agencies that pursue the public interest can inadvertently engender price distortions, due to lags in the rate-making process that delay the price response to changes in market conditions.

Empirical study of property-casualty insurance (principally, automobile insurance) has usually found that rates increased following deregulation, a result consistent with the hypothesis that regulators respond to consumer interests by suppressing insurance prices. However, the results from those studies examining workers' compensation insurance rates have been decidedly mixed. The empirical study of rates and deregulation is very difficult, and it is likely that no empirical study will ever surmount all of the problems and completely dispose of the issue once and for all. Nevertheless, we believe that we improve on previous research in at least two important ways.

First, while earlier studies typically used relatively simple measures of the regulatory environment (often, states were categorized solely as "regulated" or "deregulated" jurisdictions), we use a more complex characterization of the regulatory environment in order to capture the actual practices of the state regulatory agency as well as interstate differences in statutory regimes. We categorize state insurance market regulatory regimes as

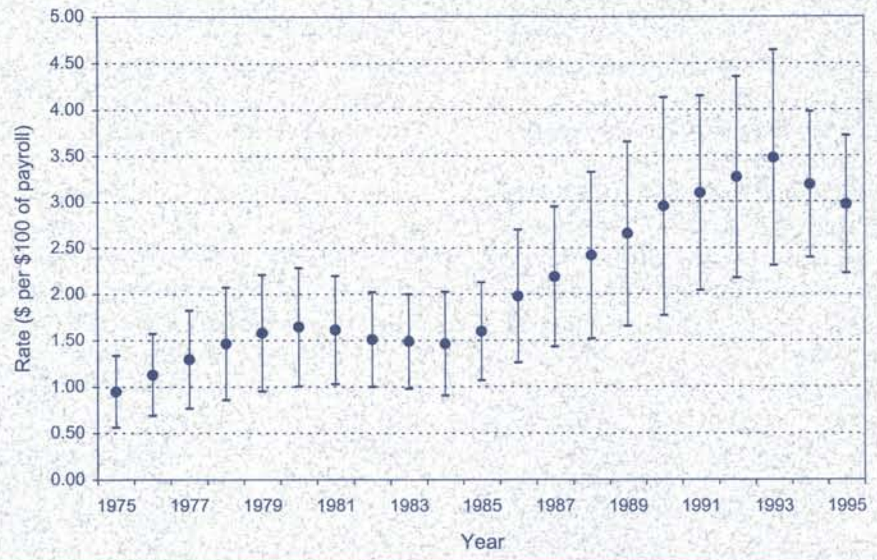
- pure administered pricing, under which all insurers must use an identical set of manual rates that a) include an allowance for benefit payments ("loss costs") as well as loadings for factors such as underwriting expenses, b) were developed by a rating bureau, and c) have been approved by the state regulatory agency;
- comprehensive deregulation, under which rating bureaus only publish loss costs and insurers are permitted to set their own rates without first seeking approval of state regulators; or
- three forms of partial deregulation, where at least one of the elements of the pure administered pricing system has been dismantled.

Second, because workers' compensation insurance rates vary among employers both within and among jurisdictions, it is difficult to measure the costs of workers' compensation insurance actually paid by employers. Consequently, most previous research has relied on proxies such as the ratio of incurred losses to premiums written. We use measures that accurately reflect the workers' compensation insurance costs actually paid by the average employer in a particular state during a particular year.

Figure 1 depicts summary statistics of rate estimates for 48 U.S. jurisdictions in the period 1975–1995. On average, the employers' cost of workers' compensation insurance rose markedly over the study period, from 0.95 percent of payroll in 1975 to 2.97 percent in 1995. The cyclical nature of insurance pricing is also evident from the figure. Finally, the data reveal that interstate variation in adjusted manual rates increased considerably between 1985 and 1990; thereafter, the variation generally declined.

Since workers' compensation insurance costs are affected by a variety of factors in addition to the regulatory environment, a simple comparison of costs under different regulatory regimes is inappropriate. Consequently, we estimated multiple regression equations predicting employers' workers' compensation costs as a function of the regulatory regime variables as well as a variety of controls. These controls included the levels of cash and medical benefits, the injury rate, and the proportion of the workforce covered by the state workers' compensation program, as well as state and year dummies to control for unobserved state- and time-invariant factors affecting employer costs. In addition, we also attempted to examine the interaction among the regulatory regime, the state of the insurance market, and the behavior of the regulatory agency prior to deregulation.

Figure 1 National Average Adjusted Manual Rates (±1 S.D.) 1975-95



Empirical Results

Most forms of partial deregulation are, on average, associated with higher employer costs for workers' compensation. On the other hand, the most comprehensive form of deregulation—loss cost systems that do not require prior approval—is, on average, associated with lower employer costs. In addition, the impact of deregulation on costs depends not only on the statutory form of deregulation, but also on the behavior of the regulatory agency prior to deregulation; where the regulatory agency has suppressed rates, deregulation is more likely to lead to increased costs. The behavior of the regulatory agency is apparently related to the state of the insurance market; regulatory agencies are more likely to suppress rates during a hard market (when insurance demand exceeds supply and prices are increasing) than during a soft one. Consequently, the impact of deregulation varies over the insurance cycle.

What may we conclude from these results? Given the contradictory findings for partial and comprehensive deregulation, it is difficult to draw clear inferences concerning the nature of regulation, i.e., whether regulatory agencies are more likely to respond to employers and suppress rates or whether they are more likely to help the insurance industry cartelize the market. Our inability to do so leads us to conclude that regulators do neither, at least not consistently. Lags inherent in the regulatory process may be responsible for the inconsistent findings. However, it may also be due to the ebb and flow of political pressures over the course of the insurance cycle. As the market hardens, political pressures from employers may force regulators to become more concerned with the impact of insurance rates on the state's business climate, and as a result, rates are suppressed. When the market softens once again, the political pressures ease and, concomitantly, regulators' concerns over the effect of workers' compensation rates vanish and rates are allowed to rise to competitive (and, perhaps, supracompetitive) levels.

Insurers respond to this pattern of regulatory behavior by increasing prices during the soft phase of the insurance cycle, which is easier to accomplish where the market has been partially deregulated. Anticipating rate suppression when the market hardens again, insurers in partially deregulated systems are likely to keep market rates higher than the competitive level during the soft phase of the cycle. In a partially deregulated environment, this is facilitated by the rating organization, which promulgates rates that serve as a pricing point for insurance carriers. This accounts for the asymmetry between comprehensive and partial deregulation. Comprehensive deregulation results in lower prices during both phases of the insurance cycle, while insurers take advantage of regulatory indifference to increase rates, during the soft phase, in anticipation of the coming crunch when the market hardens once again.

This interpretation of our results leads us to conclude that a completely deregulated market is a more efficient delivery system and is, therefore, preferable to either partial deregulation or administered pricing. The latter two alternatives seem to be associated with inefficiencies resulting from insurer uncertainty over their ability to respond to market changes. Furthermore, anecdotal evidence from states such as Rhode Island and Maine suggest that insurance rate regulation can sometimes have near-catastrophic consequences for all of the stakeholders in the workers' compensation program.

Terry Thomason is director of the Charles T. Schmidt, Jr., Labor Research Center at the University of Rhode Island. Timothy Schmidle is a senior research associate at the Cornell University School of Industrial and Labor Relations. John Burton is a professor and former dean of the School of Management and Labor Relations at Rutgers University.

Business Outlook on the Web

Business Outlook is the second of the two periodicals that the W.E. Upjohn Institute publishes quarterly, and it is now being made available on-line as part of the Upjohn Institute Web site. Under the direction of the Institute's senior regional analyst, George Erickcek, *Business Outlook* provides discussion and analysis of the economic conditions and business developments in west Michigan.

Each issue contains a "Viewpoint" article on a topic of current interest, summaries of the national and regional economies, and statistics and discussion of the overall economy in the state of Michigan. The remainder of the issue focuses on west Michigan, including sections on the three major metropolitan statistical areas (MSAs) in the region: Benton Harbor, Grand Rapids/Muskegon/Holland, and Kalamazoo/Battle Creek.

In addition to featuring the most recent quarterly statistics for the region, *Business Outlook* summarizes recent business activity such as mergers, plant expansions, and plant closings. An appendix provides detailed statistics for the west Michigan MSAs and selected national data.

Among the other features you will find on the Institute's Web site are seven Research Hubs, topic-specific pages on which we gather links to working papers, books, technical reports, and other information found on our site. If you're interested in Economic Development and Local Labor Markets, Disability and Workers' Compensation, Welfare-to-Work, Unemployment Insurance, Work Arrangements, Workforce Quality: Education and Training, or Family Labor Issues, you'll want to bookmark these pages. Other features of our site include the full text of many Institute publications and reports, including staff working papers, articles from *Employment Research,* and the first chapters of selected Institute books. Visit us at http://www.upjohninst.org.

Seeking Manuscripts

The Institute publishes books on subjects of importance to policymakers, labor economists, and practitioners who study labor market problems and programs to address them.

The majority of the books we publish originated from our Grant Program or for the Institute's in-house staff of professional economists. However, we also invite submissions of publishable book-length manuscripts and proposals for books from outside scholars and policy analysts. These submissions will be reviewed promptly by Institute staff, and manuscripts that appear promising will receive external anonymous peer review.

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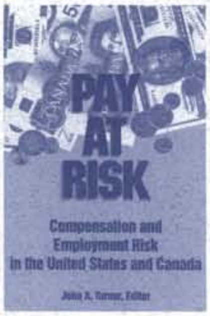
New Books from the Upjohn Institute

Pay at Risk

Compensation and Employment Risk in the United States and Canada

John A. Turner, editor

This book investigates whether employment and compensation risks for U.S. and Canadian workers have increased. The authors examine both wage and nonwage aspects of compensation, and whether workers in either country face more job-related risks. They also seek to identify trends in risk bearing and whether they differ by country. Included are



- Wage and Job Risk for Workers, John A. Turner
- Risk in Employment Arrangements, Sophie M. Korczyk
- Health and Coverage at Risk, Robert B. Friedland, Laura Summer, Sophie M. Korczyk, and Douglas E. Hyatt
- Risk Sharing through Social Security Retirement Income Systems, John A. Turner
- Risk Bearing in Individual and Occupational Pension Plans, James E. Pesando and John A. Turner
- Risk Shifting in Workers' Compensation, Douglas E. Hyatt

215 pp. $36 cloth ISBN 0-88099-222-0
$19 paper ISBN 0-88099-221-2 / 2001.

Labor, Business, and Change in Germany and the United States

Kirsten S. Wever, editor

How and why nations adopt systemic change reveals much about their underlying economic, societal, and governmental bases. Such lessons are evident in this new volume that explores how two nations with widely divergent political economies—Germany and the United States—embraced change in four contemporary settings: telecommunications deregulation and privatization, management development systems, supplier relations, and employment relations.

The individual chapters explore the tradeoffs necessitated by each country's institutions and include comparisons of sectoral and firm-level adjustment processes for change. Included are

- Mutual Learning with Trade-offs, Kirsten W. Wever
- Deregulation and Restructuring in Telecommunications Services in the United States and Germany, Rosemary Batt and Owen Darbyshire
- Institutional Effects on Skill Creation and Management Development in the United States and Germany, David Finegold and Brent Keltner
- National Institutional Frameworks and Innovative Industrial Organization, Steven Casper
- Perils of the High and Low Roads, Lowell Turner, Kirsten S. Wever, and Michael Fichter

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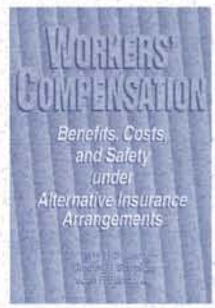
$17 paper ISBN 0-88099-215-8 / 2001.

Workers' Compensation

Benefits, Costs, and Safety under Alternative Insurance Arrangements

Terry Thomason, Timothy P. Schmidle, and John F. Burton, Jr.

Thomason, Schmidle, and Burton make use of a unique data set to delve into how insurance arrangements affect several objectives of the workers' compensation (WC) program. They underscore the effects of deregulation and other changes in WC insurance pricing arrangements by performing empirical analyses that use state-specific cost, benefit, and injury data from 48 states for 1975–1995.



This allows them to address the interactive relationships among the objectives of WC systems and how various public policies adopted by states or the federal government work to achieve them.

Several important contributions result. For instance, the authors quantify the trade-offs between adequacy and affordability that would result from a federal mandate requiring adequate benefits. They also provide analysis of the possible trade-offs in using different public policies regarding insurance arrangements, e.g., the expected savings to employers from deregulation of private insurance carriers. Overall the authors' results clarify the complicated relationships between insurance arrangements and employers' costs, and the impact of regulation on employers' costs, WC insurance market structure, and workplace health and safety.

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